

**COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF TELECOMMUNICATIONS AND ENERGY**

D.T.E. 01-____

PREFILED TESTIMONY OF CHERYL F. YAGER

1 **I. INTRODUCTION**

2 **Q. Please state your name and business address.**

3 A. My name is Cheryl F. Yager. My business address is 504 Lavaca Street, Suite
4 800, Austin, Texas 78701.

5 **Q. By whom are you employed and in what capacity?**

6 A. I am the Assistant Treasurer for Southern Union Company ("Southern Union" or
7 the "Company"). The Treasury group is responsible for all debt management for
8 the Company, as well as cash management. In that capacity, I am presenting
9 testimony concerning Southern Union's petition for authorization to issue long-
10 term debt not to exceed \$400 million.

11 **Q. Please briefly summarize your educational and professional background.**

12 A. I have a Bachelor of Business Administration from Texas A & M University and
13 a Masters of Business Administration from Southwest Texas State University. I
14 am also a Certified Public Accountant. I have been employed by Southern Union
15 since November 1992 and have held various positions including Accounting
16 Manager and Manager of Treasury and Budgeting. I have been the Assistant
17 Treasurer since September 1993.

1 **Q. As Assistant Treasurer, what are your responsibilities?**

2 A. I am primarily responsible for long-term and short-term debt and lease
3 management and cash management for the Company. I also am responsible for
4 regulatory filings related to financings.

5 **Q. Have you previously testified before this or any other Commission?**

6 A. No, although I have been responsible for preparing and supporting regulatory
7 filings, I have not previously been called upon to testify formally.

8 **Q. Would you please provide a brief description of the Company?**

9 A. Southern Union Company, a Delaware corporation, is one of the largest natural
10 gas utilities in the United States. The Company's primary business is the
11 distribution of natural gas as a public utility through its operating divisions
12 located in Massachusetts (Fall River Gas and North Attleboro Gas), Rhode Island,
13 Texas, Missouri, Florida and Pennsylvania. Southern Union completed the
14 acquisition of North Attleboro Gas Company and Fall River Gas Company on
15 September 28, 2000.

16 **Q. What is the purpose of your testimony?**

17 A. My testimony describes and supports the Company's request for authorization to
18 issue up to \$400 million principal amount of long-term debt. My testimony also
19 demonstrates that the issuance meets the "net-plant test" established by the
20 Department pursuant to G.L. c. 164, § 16.

II. DESCRIPTION OF THE PROPOSED FINANCING

Q. Please provide a summary of the Company's proposed financing.

A. The Company proposes to issue on or before June 20, 2001 up to \$400 million principal amount of unsecured Senior Notes with a maturity of 7 to 30 years at a fixed rate of interest (the "Long-term Debt"). This debt will be issued under the same indenture as our currently outstanding 7.6 percent and 8.25 percent Senior Notes. We expect that these Senior Notes will be sold in the public market. The proceeds from the issuance of the Long-term Debt will be used to refinance outstanding short-term debt, which was incurred by the Company to fund expenditures for capitalizable additions, as well as the acquisition, extension and improvement of utility property, plant and equipment.

Q. Please describe the terms of the Company's debt instrument.

A. The Company currently anticipates that the debt issuance will be a single issue of Senior Notes with a single maturity date, but no Senior Note will mature more than 30 years from the date of issuance. The Company does not currently anticipate including a call feature. The Company may reconsider these terms, or may include other terms, should market circumstances warrant such reconsideration at the time of the issuance.

Q. Please describe how the proposed Long-term Debt would be sold.

A. As mentioned above, the proposed Long-term Debt would be sold in the public market. Specifically, the Company anticipates selling its Senior Notes through agents, competitive bidding, negotiation with underwriters, negotiation directly

1 with investors, to one or more agents as principal for resale to investors, or a
2 combination thereof. The method of sale will be determined by the Company
3 based on a number of factors, including: (1) market conditions; (2) size of issue;
4 and (3) maturity. The Company would prefer to maintain its flexibility to tailor
5 the size of offerings, maturities and redemption terms to particular investor
6 requirements.

7 **Q. In your opinion, what will the borrowing rate be for the Company's**
8 **proposed debt?**

9 A. Southern Union's Senior Notes are currently rated BBB+ by Standard and Poor's
10 Global Utility Ratings Service and Fitch IBCA, Duff & Phelps and Baa2 by
11 Moody's Investor Services. As of January 31, market indications were that the
12 Company could issue seven-year notes at a coupon rate of 7.15 percent and 30-
13 year notes at a coupon rate of 8.00 percent. However, capital markets have been
14 extremely volatile over the last several years, with fairly large swings in interest
15 rates occurring in relatively short periods of time. We are, therefore, unable to
16 anticipate market conditions during the period that we are proposing to issue the
17 Long-term Debt and are requesting that the Department's Order provide for a
18 maximum interest rate of 9.00 percent.

19 **Q. What is the anticipated date of closing for this financing?**

20 A. As discussed below, it is necessary for the Company to go to market with this
21 issue no later than June 20, 2001, but the precise timing is contingent upon our
22 receipt of regulatory approvals and prevailing market conditions. In this filing,

1 the Company is proposing to convert certain outstanding short-term debt to long-
2 term debt. The bulk of the Company's outstanding short-term debt is in the form
3 of a 364-day term loan (the "Term Loan"), which is scheduled to mature on
4 August 27, 2001. Under the provisions of the Term Loan, the Company has the
5 option to extend the maturity date to August 26, 2002, provided that the Company
6 serves notice of its intent to extend no later than June 27, 2001. Once such notice
7 is provided, the Company's election to extend the maturity date is irrevocable.
8 Accordingly, the Company is working to complete the long-term financing
9 arrangements in advance of the June 27, 2001 notification deadline, i.e., by no
10 later than June 20, 2001.

11 The Company needs to complete the issuance of the Long-term Debt by June 20,
12 2001 in order to have adequate time to evaluate the results of the issuance and to
13 determine the precise amount of short-term debt that will be extended. In order
14 for the Company to complete its long-term debt issuance by June 20, 2001, the
15 Company will need to have obtained the approval of the Department of
16 Telecommunications and Energy (the "Department") no later than May 1, 2001.

17 **Q. Is the issuance of the Long-term Debt subject to approval by any regulatory**
18 **agency other than the Department?**

19 A. Yes, the issuance of securities of this type requires filings in Florida and
20 Pennsylvania. On August 22, 2000, the Florida Public Service Commission
21 granted blanket authorization for the issuance and sale of securities, which would
22 include the Long-term Debt issuance. We are currently in the process of

1 preparing and filing a Securities Certificate in Pennsylvania. Pennsylvania
2 public-utility regulation allows for a 30-day registration period that may be
3 extended by written order of the commission for an additional 30-day
4 consideration period. Therefore, we anticipate that authorization by the
5 Pennsylvania Public Utilities Commission will be obtained no later than 60 days
6 from the date of filing.

7 **Q. In your opinion, is the issuance of the Long-term Debt in the public interest?**

8 A. Yes. The proposed issuance of up to \$400 million principal amount of long-term
9 debt is reasonably necessary to retire short-term debt, which was used to fund
10 expenditures for capitalizable additions, as well as the acquisition, extension and
11 improvement of utility plant and property, which is a legitimate purpose in
12 meeting a company's utility-service obligations. In addition, as I describe below
13 in detail, the issuance meets the Department's "net-plant test," established
14 pursuant to G.L. c. 164, § 16.

15 **II. NET-PLANT TEST**

16 **Q. Please describe Exhibit SU-2.**

17 A. Exhibit SU-2 provides details on the Company's property, plant and equipment
18 and its total capitalization following the issuance of the proposed financing.

19 **Q. Would you please explain what is demonstrated by Exhibit SU-2?**

20 A. G.L. c. 164, § 16 generally requires that the fair structural value of the Company's
21 plant be sufficient to support the Company's total capitalization after any

1 proposed issuances of equity or long-term debt. As discussed in detail below, and
2 upon the advice of Counsel, I have made several adjustments to the Company's
3 most recent financial statements to determine net-utility plant and total
4 capitalization in accordance with Department precedent as it relates to the "net-
5 plant test," established pursuant to G.L. c. 164, § 16. Exhibit SU-2 demonstrates
6 that following the issuance of the proposed financing, Southern Union will have
7 net-utility plant (as adjusted) of \$1.467 billion, excluding Construction Work In
8 Progress, and total capitalization (as adjusted) of \$1.214 billion such that its total
9 net-utility plant (as adjusted) will exceed its total capitalization by \$253,772,000.

10 **Q. Please describe Exhibits SU-3 and SU-4.**

11 A. Exhibit SU-3 is the Company's Form 10-Q for the quarterly period ending
12 December 31, 2000, which was filed with the Securities and Exchange
13 Commission (the "SEC") on February 14, 2001. The Company's most recent
14 consolidated balance sheet for the period ending December 31, 2000 is set forth at
15 Exhibit SU-3, pages 5-7. Exhibit SU-4 shows certain adjustments that the
16 Company has made to the figures set forth in the consolidated balance sheet in
17 preparing its comparison of post-issuance net-utility plant to total capitalization.

18 **Q. Please describe the present capitalization of the Company and indicate the**
19 **ownership of its outstanding securities.**

20 A. The Company's capital structure is shown on Exhibit SU-3, at page 6. As of
21 December 31, 2000, there were 51,982,168 share of common stock outstanding at
22 a par value of \$1.00 per share, for an aggregate par value of approximately \$52
23 million. Premium on capital stock amounted to \$627.5 million. The Company's

1 total common stockholders' equity was approximately \$720.7 million. Also as of
2 December 31, 2000, there were \$15.9 million in treasury stock (at cost). Treasury
3 stock represents shares that have been repurchased by the Company, and
4 therefore, are no longer considered outstanding. Common stock held in trust
5 totaled \$17.0 million and reflects shares held in various grantor trusts or "rabbi
6 trusts," which are established to fund deferred compensation for key employees
7 and directors of the Company. Similarly, Deferred Compensation relates to
8 common stock held in trust for directors of the Company. Accumulated Other
9 Comprehensive Income of approximately \$63.0 million primarily represents the
10 net gain resulting from changes in the market value of an investment that is held
11 by a subsidiary of the Company, which is discussed in further detail below. The
12 Company has retained earnings totaling \$10.2 million.

13 The Company's balance sheet also reflects 4 million shares of preferred securities,
14 which were issued by a subsidiary trust of the Company with an aggregate book
15 value of \$100 million. The Company's long-term debt and capital lease
16 obligations as of December 31, 2000 total approximately \$1.381 billion, resulting
17 in a total capitalization of \$2.202 billion.

18 **Q. Have you made any adjustments to Exhibit SU-3 in preparing the**
19 **Company's post-issuance comparison of net-utility plant to total**
20 **capitalization?**

21 A. Yes. The Company has made a number of pro forma adjustments to its
22 consolidated balance sheet for the purpose of comparing the post-issuance net-
23 utility plant to total capitalization. These adjustments are set forth in Exhibit

1 SU-4. As discussed below, these adjustments are consistent with Department
2 precedent.

3 First, the Company has reduced the Long-term Debt and Capital Lease Obligation
4 shown in Exhibit SU-3, at page 6, by \$529 million reflecting the outstanding
5 balance as of December 31, 2000 of the Company's 364-day Term Loan (denoted
6 as adjustment (A) on Exhibit SU-4). Although the Term Loan is a 364-day short-
7 term obligation (with a possible 364-day extension), accounting rules require that
8 it be classified as long-term debt for consolidated financial reporting purposes on
9 the Company's Form 10-Q. Accounting rules require this treatment because the
10 short-term debt was used to finance long-lived assets and because the short-term
11 debt will ultimately be refinanced with long-term instruments. See, Statement of
12 Financial Accounting Standards No. 6. I have been advised by Counsel that this
13 adjustment is consistent with Department precedent regarding short-term
14 obligations, and therefore, the Company has reduced its Long-term Debt and
15 Capital Lease Obligation by \$529 million for the purpose of comparing the
16 Company's post-issuance net-utility plant-in-service to total capitalization.

17 Second, the Company has removed from Property, Plant and Equipment, net
18 property, plant and equipment relating to unregulated business operations, which
19 is reflected in Exhibit SU-3, at page 5. As calculated in Exhibit SU-4, the
20 Company has reduced its net plant-in service by \$51,772,000 (plant-in-service of
21 approximately \$76,105,000, less accumulated depreciation of approximately
22 \$24,333,000), to account for unregulated operations, which are presented on a

1 consolidated basis with the Company's regulated operations on the balance sheet
2 (set forth in Exhibit SU-3, at 5-7). Consistent with this adjustment to net utility
3 plant-in-service, the Company has reduced its total capitalization by
4 approximately \$51,772,000 to reflect the removal of unregulated property, plant
5 and equipment from the net-utility plant for the purpose of the "net-plant test"
6 calculation. The unregulated property, plant and equipment removed from the
7 net-utility plant-in-service is supported by a combination of debt and equity, but
8 having been incorporated over time into the Company's overall operations, cannot
9 be directly attributed to a particular source of capital. Accordingly, the Company
10 has reduced its total capitalization in the amount of \$51,772,000 by reducing
11 outstanding debt and equity (both common and preferred) in the same ratio that
12 those categories of capital have to the Company's total capitalization.
13 Specifically, the Company's total capitalization consists of approximately 51
14 percent long-term debt, 43 percent common-stock equity and 6 percent preferred-
15 stock equity. Therefore, the Company has apportioned the \$51,772,000 between
16 debt and equity in the following manner: (1) by reducing long-term debt by
17 \$26,370,000; (2) by reducing common-stock equity by \$22,307,000; and (3) by
18 reducing preferred securities by \$3,095,000. I have been advised by Counsel that
19 this adjustment is consistent with Department precedent, which requires a utility
20 to demonstrate that its net-utility plant-in-service will be equal to or exceed its
21 total capitalization following the issuance of the security for which it is seeking

1 authorization by the Department. This adjustment (to both net utility plant and
2 total capitalization) is denoted on Exhibit SU-4 as adjustment (B).

3 Similarly, the Company has made a third adjustment in performing the net-plant
4 test calculation, which entails the removal of the Additional Purchase Cost
5 Assigned to Utility Plant (net of amortization), totaling \$733,893,000, from
6 Property, Plant and Equipment, as presented in Exhibit SU-3, at page 5. Over the
7 past several years, the Company has completed a number of acquisitions of
8 regulated natural gas distribution companies. The Additional Purchase Cost of
9 \$733,893,000 reflects the excess of the purchase prices of the acquired companies
10 over the book value of the assets acquired. Although the fair market value of the
11 Company's utility property, plant and equipment properly reflects the Additional
12 Purchase Cost, I have excluded these costs for the purpose of the net-plant test
13 calculation. Consistent with the removal of Additional Purchase Cost Assigned to
14 Utility Plant from Property, Plant and Equipment, the Company has reduced its
15 total capitalization by \$733,893,000 to reflect the removal of Additional Purchase
16 Cost Assigned to Utility Plant from the net-plant test calculation. I have been
17 advised by Counsel that this is consistent with the Department's recent treatment
18 of additional purchase costs in relation to the conversion of short-term debt to
19 long-term debt. See Massachusetts Electric Company, D.T.E. 00-53, at 9 (2000).

20 The Additional Purchase Cost Assigned to Utility Plant is supported by a
21 combination of debt and equity, but having been incorporated over time into the
22 Company's overall operations, cannot be directly attributed to a particular source

1 of capital. Accordingly, the Company has reduced its total capitalization in the
2 amount of \$733,893,000 by reducing outstanding debt and equity (both common
3 and preferred) in the same ratio that those categories of capital have to the
4 Company's total capitalization. Therefore, the Company has apportioned the
5 \$733,893,000 between debt and equity in the following manner: (1) by reducing
6 long-term debt by \$373,806,000; (2) by reducing common-stock equity by
7 \$316,209,000; and (3) by reducing preferred securities by \$43,877,000. This
8 adjustment (to both net-utility plant and total capitalization) is denoted on Exhibit
9 SU-4 as adjustment (C).

10 Fourth, the Company has reduced its total capitalization by approximately
11 \$62,983,000 million, reflecting the Company's Accumulated Other
12 Comprehensive Income as of December 31, 2000 (denoted as adjustment (D)).
13 This line item represents the net gain resulting from changes in the market value
14 of certain investment securities that are held available for sale by a subsidiary of
15 the Company. Financial Accounting Standard No. 115 requires that these
16 investments be "marked to market" and any related gain or loss be shown on the
17 Company's balance sheet as Accumulated Other Comprehensive Income, net of
18 income taxes. The market value of these investment securities (approximately
19 \$105,587,000) is listed under "Current Assets" in Exhibit SU-3, at page 5 and the
20 related after-tax gain of approximately \$63 million, is listed under Accumulated
21 Other Comprehensive Income in Exhibit SU-3, at page 6. Because this line item
22 is associated directly with a Current Asset and not with the Company's Property,

1 Plant and Equipment as shown in Exhibit SU-3, it does not serve as capitalization
2 of Property, Plant and Equipment. Accordingly, for the purpose of making a post-
3 issuance comparison of net-utility plant-in-service to total capitalization, the
4 Company has removed this line item from its calculation.

5 In addition, the Company has excluded Retained Earnings of approximately
6 \$10,228,000 from its total capitalization. The exclusion of Retained Earnings is
7 denoted as adjustment (E) on Exhibit SU-4. Also, the Company has made pro-
8 forma adjustments to its consolidated balance sheet to remove Construction Work
9 In Progress of \$30,611,000 (denoted as adjustment (F)) and to include natural gas
10 inventories held by the Company's regulated utility divisions, which total
11 approximately \$103,976,000 (denoted as adjustment (G)), as calculated on
12 Exhibit SU-4.

13 **IV. REQUESTED EXEMPTIONS FROM §§ 15 AND 15A**

14 **Q. Why is the Company seeking a Department exemption from the bid**
15 **solicitation requirements of G.L. c. 164, § 15?**

16 A. The Company's ability and readiness to respond quickly to market changes is
17 important for the effective utilization of both negotiated offerings and sales
18 through agents. The Company is requesting an exemption from the bid
19 solicitation requirements of G.L. c. 164, § 15 because an exemption would
20 provide the Company with the needed flexibility to respond to market conditions
21 and opportunities that might otherwise be lost if the public solicitation and
22 bidding requirements of Section 15 had to be followed.

1 **Q. Why is the Company seeking a Department exemption from the**
2 **requirements of G.L. c. 164, § 15A relating to the issuance or sale of debt**
3 **instruments at par value or face amount?**

4 A. The Company believes that it is in the public interest to grant an exemption from
5 the par value requirement because market conditions may make it difficult for the
6 Company to price a particular issue at par value and simultaneously offer an
7 acceptable coupon rate to prospective buyers. An exemption from the
8 requirements of § 15A will enhance the Company's flexibility to enter the market
9 quickly to take advantage of prevailing interest rates.

10 **Q. Does this complete your testimony?**

11 A. Yes, it does.

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